

DOW THEORY LETTERS INC.

RICHARD RUSSELL
P.O. Box 1759
La Jolla, Calif. 92037

36 Letters per Year — \$75 Annually

Registered with the Securities Exchange Commission

July 18, 1973

Letter 569

July 6, DJIA 870.11, PTI 707, A-D ratio -15.37

July 13, DJIA 885.99, PTI 709, A-D ratio -14.30

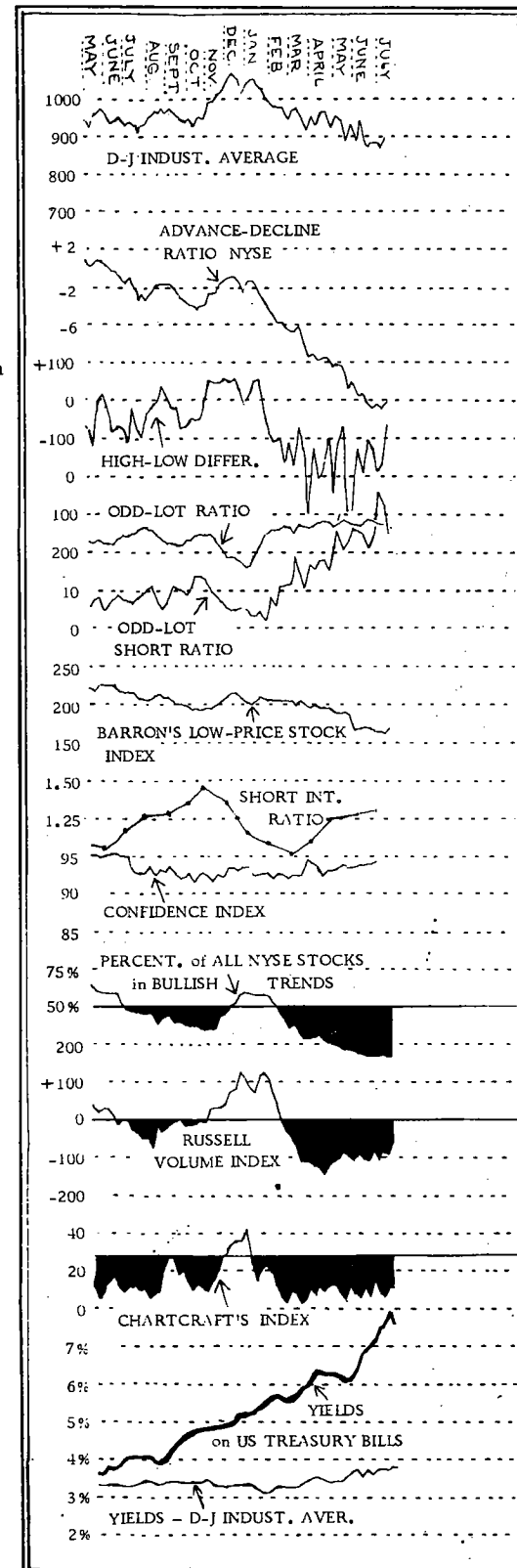
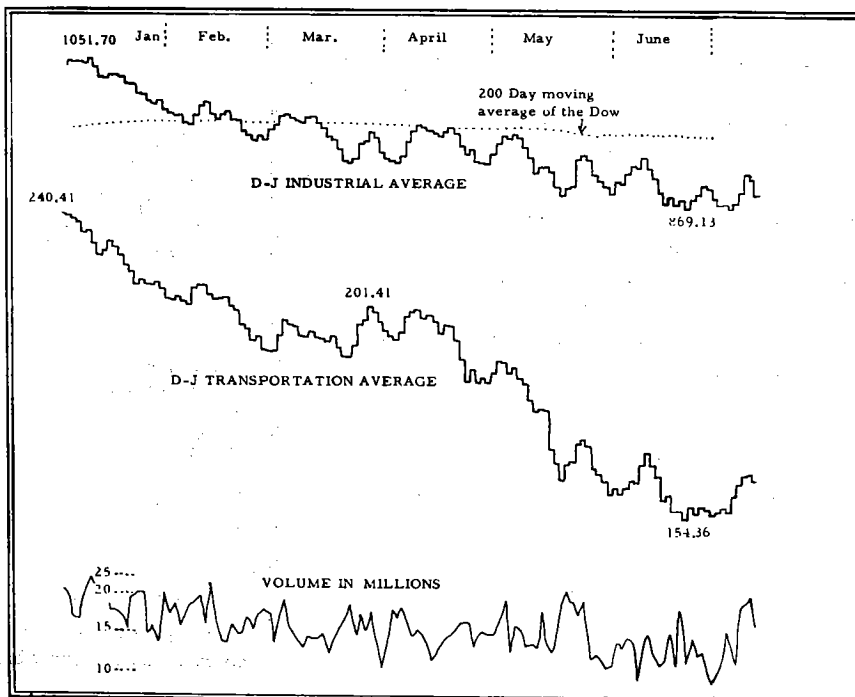
THOUGHT: Can you have chronic inflation simultaneously with deflation in the classic inflation-hedge "assets in the ground" stocks like the oils, steels, coppers, etc? Well, it would be kind of unusual, only — it's happening.

THE MARKET: Here are the cold figures. The Dow closed on the last day of December, 1972, at 1020.02
Jan. 31, 1973 (last day of January) at 999.02
Feb. 28, 1973 (last day of February) at 955.07
Mar. 30, 1973 (last day of March) at 951.01
April 30, 1973 (last day of April) at 921.43
May 31, 1973 (last day of May) at 901.41
June 29, 1973 (last day of June) at 891.71

Count them, and you will note that the Dow Industrials closed lower (end of the month closings) for six months in a row during 1973. Lest you think this is commonplace, my records show that this feat has been surpassed only once in the last century, and that was in the period of July, 1941, to April, 1942, during which time the Dow closed lower for nine consecutive months. That decline occurred within the framework of a primary bear market and amid the depths of World War II.

For the record, the Dow closed lower for five consecutive months during February to June, 1932, at which time a major primary bear market was in progress. The other five-in-a-row "downer" occurred during April to September, 1966, during the first phase of the current primary bear market.

What I am trying to do is put the whole 1973 decline into perspective. In sinking for six months in a row, the Dow surpassed all downside action in terms of sheer consistency since 1942. And as I have been pointing out in recent Letters, the approximate 200-point drop in the Dow does not begin to measure the damage which has befallen the rest of the market.



I am including (left of page) my weekly chart of the Dow together with three technical indicators which I follow. The Russell Primary Trend Index (PTI) is made up of the D-J Industrial, Transport and Utility Averages, the S & P 500 Index, the most-active stock index, the 40-Bond Average, the A-D ratio and the High-Low Index. This broad gauge of technical strength (or weakness) has sustained a straight-line collapse which has literally "cut the market to ribbons." Since December, 1972, the PTI (figures shown on the top of page one of each mailing) has been unflagging in signalling danger.

The A-D index of the 30 Dow stocks has most definitely broken its 1971 low, confirmation of which on the part of the Industrial Average, would require a reading below 797.97. Lastly, the A-D ratio (gauging the advancing or declining tendencies of all listed NYSE issues) has suffered a shattering collapse, a collapse which for stubborn downward momentum and resistance to rally has had few parallels in stock market annals.

What are we to deduce from all this data? Simply that during 1972-73 we are seeing (I hesitate to say "have seen") one of the great and classic Wall Street slides of modern history. The fact that the Dow closed lower for six months in a row certainly points to the seriousness of the situation. Yet despite this, and despite the fact that most of the stock market indicators have been pulverized, one must marvel at the "holdout issues" within the Dow Average, issues which have provided

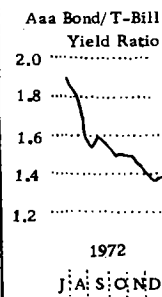
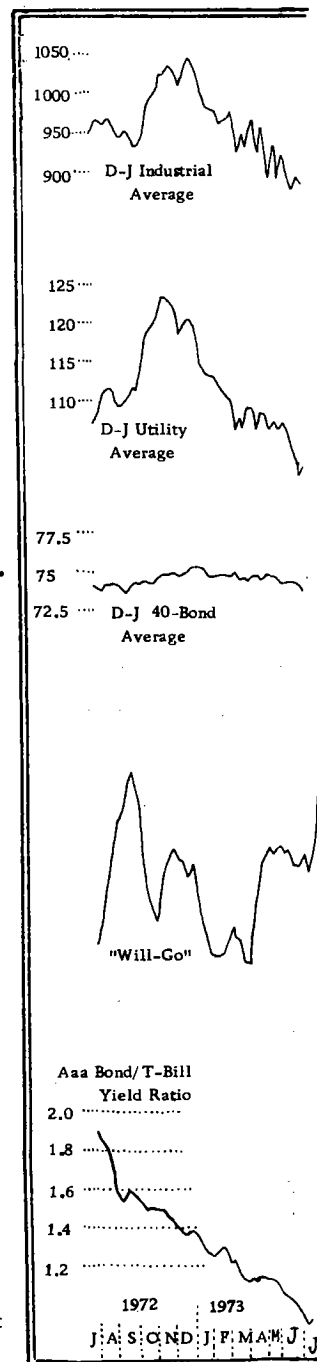
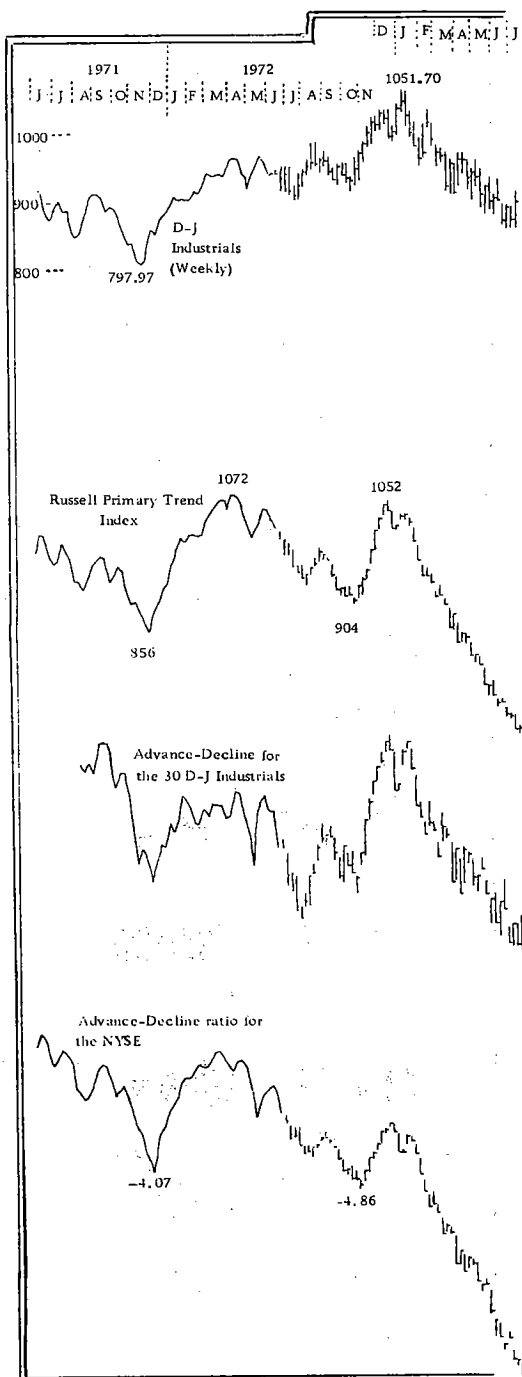
the Dow illusion of "great downside resistance."

Just five high-priced Dow stocks (Kodak, DuPont, Sears, Proctor, Exxon) make up over one-third of the Dow's value, and it is these issues (along with a few other higher priced Dow issues) which have created the image of "non-collapse" as far as the Dow is concerned.

Is history fated to look back at 1973 and the Dow Industrial Average and say, "It wasn't that bad after all." Somehow, I doubt it. There is no denying that the market has taken a vicious beating this year, but it is also well to remember that old adage that "Every dog has its day." The NYSE is hardly going out of business (despite the fact that seats have dropped from \$550 thousand to \$72 thousand), and the worst bear markets in history have provided breathing spaces in the form of upside corrections (often violent upside corrections). Therefore, I must report to readers that there comes a time in every bear market wherein even the bears (and here I refer particularly to the shorts) discover they are playing a dangerous game.

What do Dow Theorists do in primary bear markets when an upside correction seems to be developing? My suggestion is that we let the battered bulls make some money if they can. We have our gold shares, we have avoided the terrible losses suffered by those who have been holding stocks, and our policy is to avoid common stocks until the primary trend turns bullish. In the meantime, we must continue to exercise, as Charles Dow put it, "the patience of ten men." As far as the stock market is concerned, let the "body" rise if it can — or fall like a mortally wounded bull if it must.

I have been referring to the monetary scene at great length, and my "monetary chart" is updated at right. As noted in many previous reports, the monetary background for the stock market is "good" when the Utility and 40-Bond Averages are in a rising trend, "bad" when those two interest



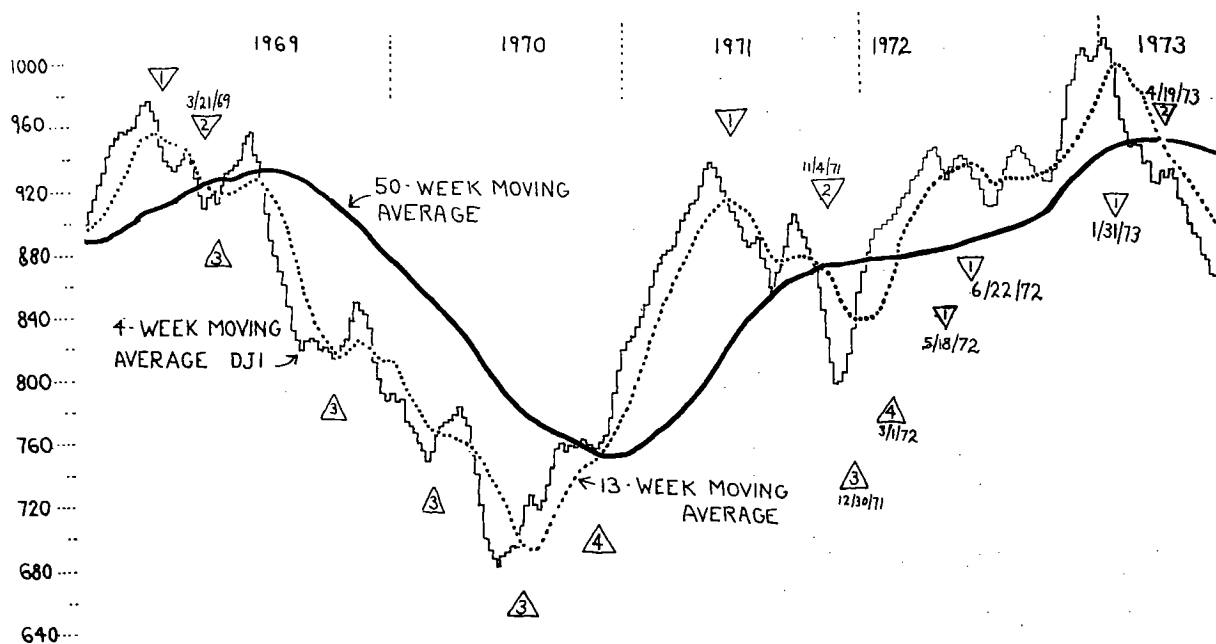
rate-sensitive indices are declining. As seen on the chart, both the Utilities and the 40-Bonds are now in declining trends — thus, the monetary background for Wall Street must be labeled negative (very few rallies of importance have materialized under these circumstances).

Next we come to our interesting little friend, "Will-Go." I have been writing that this index (based on the yield spread between Barron's Hi-Grade Bonds and the Dow Industrials) has been calling for a rally to start around the first week in July and lasting at least to the end of August. So far, Will-Go is right on target, but it is well to remember that Will-Go predicts the timing of a move, not amplitude.

Finally, the ratio of yields on Aaa Industrial bonds and 91-day Treasury bills has dived under 1.00, signifying an extraordinary situation in which Aaa bond yields are below short-term bill yields. Readers probably remember the very accurate March warning of this index (Letter 558, page 2), a warning of monetary storms ahead. Well, the current "under 1.0" reading of the index says that the storm is here.

CONCLUSION: An "oversold" and battered market has rallied amid very negative monetary conditions. It is certainly possible that the joint lows of 869.13 for Industrials and 154.34 for Transports (both recorded on June 25) were the Averages' way of discounting the worst they could see ahead at this time. If so, a secondary upward correction is in the offing. I must say that the majority of investment advisories have been shouting rally until the chorus over the past few weeks has reached a crescendo. It's seldom that easy to call 'em, but maybe Wall Street needs "a gift" during this very difficult year.

NOTE: Last week I purchased a certificate of deposit from a well known California bank. The C/D provided a 9.25% yield! If the stock market can mount a good rally against that kind of alternative, it has my sincere admiration. I've always associated 9% short-term money with a money crunch. Are we in one, and I'm the only man on earth who knows it? Hello, out there!



THOSE MOVING AVERAGES: This is probably a good time to review the moving average (MA) study of the Dow Industrials, the study which was last seen in Letter 561. If you will turn to that issue, you will remember that the chart (here up-dated) contained three moving averages of the Dow Industrials, a 4-week MA (short-term), a 13-week or intermediate-term, and a 50-week or long-term. "Preliminary signals" are given when the 4-week MA crosses above or below the 13-week MA (a #1 signal on the chart is a preliminary bearish signal, a #3 signal is a preliminary bullish signal). "Major signals" are given when the movement is powerful enough to take the 13-week MA above or below the 50-week MA. A major bearish signal is marked #2 on chart, a major bullish signal is marked #4.

Page 4 The big "mystery" in this market over the past few years has been the Dow Industrial Average. Any examination of the chartbooks, any glance at the advance-decline ratio or look at the unweighted averages (such as Value Line) will show clearly enough what has happened to the general market. In a phrase, it has collapsed. So the real mystery facing Wall Street is — "How far will the Dow go towards joining the rest of the market?"

It is this crucial question which prompted me to up-date the moving average study. And what happens over the next few months may well provide the answer to "where the Dow is going." First, a little history is needed here. Note that a #2 (major bear) signal was provided back in March, 1969. Study the chart and note what happened following this signal. First, the signal appeared amid an oversold market, and an advance got underway. The Dow rallied to May 11, and the rally shows on the chart as a strong rise in the short-term (4-week) MA. Following this rally, the market literally crashed. Note that once the #2 (major) sell signal was given, the 13-week (medium-term) MA did not re-cross above the 50-week MA, despite the strong rally.

Now we come to the 1971 sell signal, the (major) #2 sell signal of November 4, 1971. The downside force which produced this #2 signal also brought on an oversold market (as is usually the case). But this time, the #2 signal proved to be an "unsatisfactory" one (let's call it a false one). The Dow soon turned up, and it continued higher to its January, 1973, peak of 1051.70. As seen on the chart, however, the MA studies did provide signals which alerted us to the upside reversal.

The latest #2 major bear signal occurred on April 19, 1973, as reported in Letter 561 and subsequent Letters. The Dow was at 963.20 on the day of that signal, with most stocks at the time far higher than they are today. As usual, the #2 signal occurred amid powerful downside compression, and the market was shortly in "oversold" territory. Nevertheless, the market has (following the 1973 signal) acted far worse than it did following the 1969 sell signal. Note that the short-term or 4-week MA of the Dow turned down in January, 1973. It continued down after the #1 (preliminary) sell signal and after the #2 (major) sell signal, and it has been going down ever since, despite the market's appearing heavily oversold. This is a far worse performance than during 1969, when the Dow rallied sharply following the #2 signal, preparatory to its devastating descent to the 1970 bottom.

In view of all this, what can we expect next? Obviously, the current rate of descent in the 4-week moving average of the Dow cannot continue indefinitely. But the low-volume erosion, the cave-in among the vast majority of non-Dow stocks and the absence of a "clean-out" or selling climax has served to head off any rally of import (at least so far).

The three MA's on the chart are now all in the bearish position with the 4-week below the 13-week and the 13-week below the 50-week. All three MA's are currently declining in unison. Sooner or later, we will have a rally strong enough to take the 4-week MA above the 13-week MA. If the momentum of that rally is not forceful enough to reverse the downward trend of the 13-week MA, it will be an insignificant rally indeed. The severity of this decline will probably be judged by the length of time in which the 13-week MA holds below the 50-week MA. During the 1969-70 decline this situation lasted for 20 months. The current major bear situation (with the 13-week MA below the 50-week MA) has lasted for only 3 months. The MA studies will graphically and unemotionally tell us when the major bear period comes to an end (and that situation will, of course, be relayed to subscribers).

GOLD & MONEY: You're a manufacturer, and you make "Switzels." The price of Switzels is dropping all over the world because unfortunately you have made far too many of them. So what do you do? Instead of cutting back on Switzel production, you go to your bank and you borrow \$100,000. With the money you start buying Switzels on the open market. The price of Switzels (which had sunk very low) firms up a bit. You call a press conference, and you state that Switzels are "looking alot stronger," and that "the problem of a weak Switzel market may indeed be solved." That fairy tale, of course, refers to currency swaps in which the US borrows foreign currencies (we pay interest on them) with which to purchase sagging dollars. The US thereby temporarily "bolsters" the price of the dollar. It sounds utterly idiotic with Switzels, doesn't it? Then does it really sound any better with dollars?

But let's be serious. The July 8th authoritative "Comments on Credit" by Salomon Brothers (written by the brilliant Henry C. Kaufman) starts as follows: "The Gathering Storm: Both fundamental and technical developments within the last few weeks suggest that a serious and perhaps dramatic credit confrontation is unfolding. The extraordinarily high rate of inflation fueled by a bubbling economy, that is operating at close to capacity in many sectors, is at the heart of the matter.... Monetary restraint, it is now clear, will raise open market rates and slow the availability of credit; consequently, a denial of credit to some sectors of the economy is inescapable."

For many months various and sundry "experts" have been saying that there would be no credit crunch in 1973. Well, I happen to agree with Mr. Kaufman, and I flatly state that we are going into the credit crunch now. The real question, as far as I am concerned, is what happens when the pain begins? Will the Fed have the nerve to throw the nation into a business

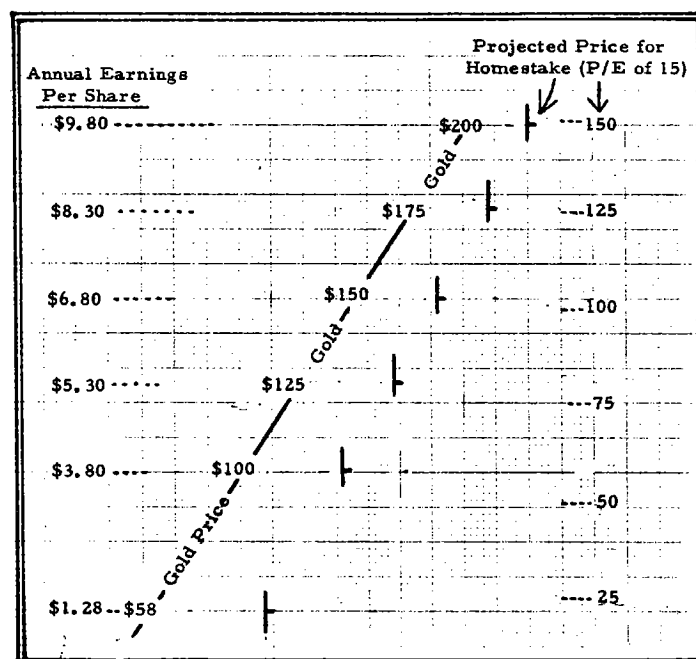
July 18, 1973

decline? The truth is that nothing less than a business slump will do the dollar any fundamental good. Is a recession what the market has been discounting during the 1973 smash? We should know within a few months.

My own guess is that history will repeat. The Fed will reverse gears in mid-stream, and as soon as business shows signs of "going soft," the Fed will ease up on restrictions. Should business turn down with anything like conviction, the money floodgates will be opened again, and we will be back where we started, with the dollar sinking to new historic lows.

In the meantime, those of us who have been holding golds for the past few years will have a new "prop" under us during this gold share correction (a correction which I had indicated was in the offing). That prop is forthcoming fat earnings for the gold shares. I expect the second and third quarter, 1973, earnings for the gold shares to be extraordinarily good, and for those who have not yet purchased all the gold shares they want, this should prove an excellent opportunity to do so. The following S. African shares (ADR's are available) should be considered now: President Steyn, Vaal Reefs, Kloof, Elsburg, East Driefontein, Western Deep Levels, President Brand, plus NYSE-listed ASA Ltd, the closed-end gold fund.

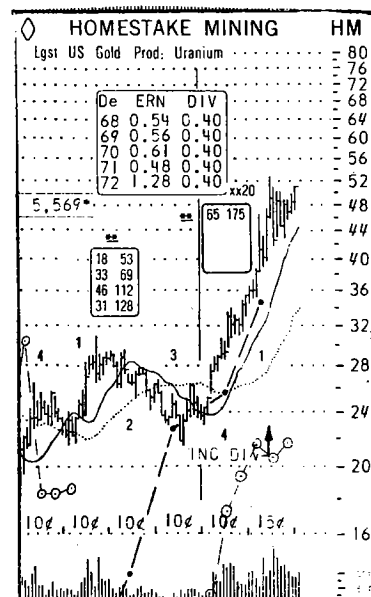
GOLD: Everybody is wondering what the gold move is all about. A great many people realize that there are billions of dollars (perhaps \$100 billion Eurodollars alone) batting about, trying to move into some "safe," non-dollar storm-cell. These same people know that when you buy General Motors or IBM or DuPont, you are buying a share of a company which works with dollars, sells items for dollars, deals with equipment valued in dollars. In other words, dollars put into these companies represent an investment in items which are subject to the vagaries and weaknesses of the dollar. So the problem is — how to put dollars into a company which deals in a "dollar-resistant" product. The answer is gold shares. The higher the dollar price for gold, the more dollars gold shares will generate in the form of earnings and dividends (plus, of course, a higher valuation for gold reserves in the ground). In other words, a slide in the dollar's value means a rise in gold's value (in terms of dollars). Gold shares, as far as US citizens are concerned, represent one of the very few vehicles with which to "beat" a collapse in the value of the dollar.



I have never seen a chart which shows just how the gold picture works in terms of gold price, earnings and the market potential for a gold stock. I have decided to draw a chart of Homestake, the US's largest gold mining company. I have constructed this chart based on this fact: each one dollar rise in the price of gold above \$70 means a 6¢ rise in HM's earnings per share. I think I have been conservative, and this is why: (1) I have seen a figure as high as 7¢ a share earnings increase in HM for each one dollar rise in the gold price. (2) I have used HM for this study, yet HM is not a total gold company in that less than 1/2 of its earnings come from gold sales. (3) I have used a conservative price/earnings ratio of 15 with which to project the price for HM, but if golds become popular the market could give them a much higher P/E ratio.

In 1972 the average price for gold worked out to around \$58. I figure HM received around the average \$58 price for gold during 1972. That year HM earned \$1.28 per share, which was up from 48¢ for the entire year 1971! For the first quarter of 1973, HM earned 65¢, which was up from 18¢ during first quarter 1972. (See chart courtesy of Quote Digest, Box 213, Wichita, KS 62701).

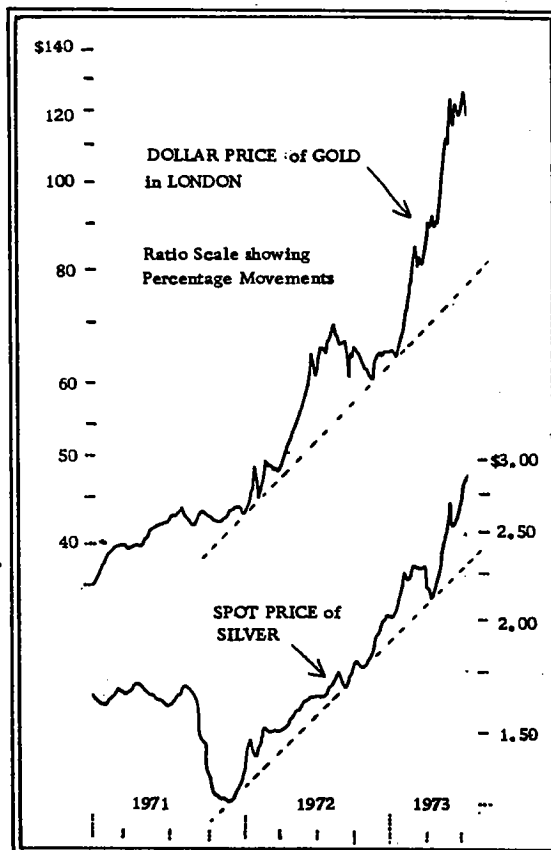
The chart shows what HM could earn at various average gold prices. At the right I show what HM could sell for, assuming it comes through with those earnings, and assuming a P/E ratio of only 15. For instance, at \$175 gold HM could earn around \$8.30 and sell for around \$125 on a P/E ratio of 15.



Page 6 So that is what the chart shows — simply the great leverage possibilities in a given gold share if, and or when the price of gold rises. (Other services please feel free to publish this chart, and I assume you will be kind enough to give me written credit).

On this page I have included a chart which I have not seen anywhere else — a ratio graph of gold and silver showing all movements in percentages since late 1970. Note that gold has recorded the largest percentage movements, whether we measure from the beginning of 1971, the late-1971 lows or the early-1973 lows. Interestingly, however, the "basic trendlines" which I have drawn under both gold and silver are rising at roughly the same angle. Gold took over on a very steep rising trendline in late-1972, and silver took off during the second quarter of 1973. Whether these sky-rocketing trendlines will hold remains to be seen. "Silver bugs" maintain that in due time the silver rise will match the gold rise in amplitude. I will not argue the point, but the fact is that so far silver has been good, very good, but it has not matched gold.

LATE NOTES: The downside momentum of this market seems to be ebbing. My weekly plurality of new highs and lows touched a bottom of minus 935 on May 25 (Dow 931). Lowest since then was a minus 611 on week ending June 22 (Dow 879). Since then its been minus 555, minus 405, and a minus 201 last week. The Averages made lows on June 25, Industrials 869.13, Transports at 154.35. A-D ratio recorded its low on July 5, Primary Trend Indicator made identical lows on July 9 and 13. Cumulative most-active stock index made a new low as late as July 13 (this one is a baaad actor). Those are all marks to watch, and if they hold we should shortly get some mileage on the upside.



Looking over the P & F charts of the 30 Dow stocks, I must admit there is no great abundance of impressive bases. If the Dow rallies, most Dow stocks will be "pulling back" from collapse-lows, but remember, if each Dow stock tacks on a few points you can get a 50 to 100 point rather profitless rally in the Dow.

Anaconda, US Steel, Alcoa, Allied Chemical all have actual bases. The Aluminum, Paper and Steel groups all have rising relative strength trends.

THOUGHTS: Has the market corrected far more than anyone realizes in real (gold) terms? For instance, the Dow would have cost an investor 28.4 oz. of gold in December, 1968. At the 870 low of a few weeks ago, the Dow would have cost 7 oz. of gold. On that basis, the Dow has dropped to 247! Even more horrendous, Value Line's broad average has dropped 88% since its 1968 high in terms of gold. During 1929 to 1932, the Dow dropped 89%. But I have always believed that the Dow adjusts for everything automatically. Perhaps that is why it has been so unresponsive in the face of the fat 1973 earnings, by which I mean that the decline in 1973 was the Dow's way of saying that despite the rise in dollar earnings, those earnings when translated into real (gold terms) were not impressive.

Fat Bishop:

"I'll make a bonfire of my books immediately,

All that are left against that side I'll sacrifice,

Pack up my plate and goods and steal away

By night at water-gate; it is but penning

Another recantation, and inventing

Two or three bitter books against the White House

And then I'm in a't'other side again

As firm as e'er I was, as fat and flourishing."

—A Game at Chess
Act III, Scene I

QUOTES: "The price of gold will soar just as high as political mistakes makes necessary." From the A.C.E. Coinletter.

"Liquidity is the order of the day. Break is the prognosis for the stock market. Crunch is the prognosis for the credit markets. Stumble is the prognosis for the economy — for the first time in years, not just inside America." Eliot Janeway from the July 11 Janeway Service.

Would you believe this (left) by Thomas Middleton, written in the late 1500's?

Would you believe this? (right) It happened in 1973.

In Malaysia, Borneo the World Health Organization sprayed DDT in a village as protection against malaria. But a number of bugs were not affected by the poison and concentrated it in their bodies, so that when pet lizards (geckos) ate the insects, they got sick and could not run away from cats, who feed on the lizards. Both geckos and cats began to die. Whereupon large jungle rats moved in and began to roam at will, along with the caterpillars who fed on the thatched roofs of the village.

Finally, they had to parachute a whole new contingent of cats to restore the balance of nature; though the WHO could not find enough geckos to bother with a lizard-drop.